Adding income through emerging market bonds

Investment strategy insights

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- Emerging market (EM) hard currency debt comprises bonds issued in US dollars or euros (rather than local currency) in developing nations. CIO rates them Attractive.
- EM fundamentals are stronger in this cycle than in prior ones, in our view, while outright yields exceed those of many developed market bonds.
- We discuss the pros and cons of investing in EM debt and the different tools to do so.

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CIO rates emerging market (EM) hard currency debt as Attractive. These are bonds issued in US dollars or euros (rather than local currency) in developing nations. With EM bond yields elevated, we expect high-single-digit returns for the JP Morgan EMBIG Diversified and CEMBI Diversified indices, well above cash rates in many advanced economies.

Despite the uncertainty of the Iran conflict, both EM sovereign and corporate bonds (JPM EMBIG Diversified and JPM CEMBI Diversified indexes, respectively) have outperformed US and European investment grade (Bloomberg US Intermediate and Bloomberg Euro Aggregate Corporate indices) by 110-220bps. EM bonds have shown resilience in the face of geopolitical stress, underscoring their potential role as a key portfolio diversifier, especially as developed markets face fiscal challenges.

EM credit was not immune to pressure in March, as tensions in the Middle East and oil supply disruptions through the Strait of Hormuz weighed on more growth-sensitive bond segments. However, the start of negotiations between the US and Iran triggered a sharp market rebound. Spreads on both sovereign and corporate EM credit have since retraced to below pre-conflict levels.

Why look now?
CIO's tactical view on EM credit remains constructive. The largest EM net energy exporters are concentrated in the Middle East and have been directly affected by export disruptions. Some, like Saudi Arabia and the UAE, have continued exporting large volumes of hydrocarbons via pipelines that bypass the Strait of Hormuz. Latin America is relatively well positioned. Asia faces more challenges as a net energy importer, having to contend with higher prices and supply risks.

EM fundamentals are stronger in this cycle than in prior ones, in our view. Cushions against turbulence include higher foreign-exchange reserves, improved current-account positions, and lower fiscal deficits. The number of distressed EM issuers has declined since last year. Corporate fundamentals have strengthened, with lower default rates and improving interest-coverage ratios. Higher oil and commodity prices are benefiting commodity-exporting EM issuers, supporting external balances and reinforcing credit profiles.

Looking ahead, we believe outright yields in EM bonds are attractive and forecast high-single-digit returns for the JP Morgan EMBIG Diversified and CEMBI Diversified indices. The macro backdrop is likely to be constructive, with the prospect of further Federal Reserve rate cuts later in 2026 helping to ensure liquidity in global markets.

We continue to believe EM debt can add value for investors with excess cash to invest, or to augment and diversify

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existing income-oriented portfolios.

Where next for yields and spreads?
As of April 2026, the EMBIG Diversified spread was 244 basis points (bps) and the CEMBI Diversified spread was 228bps. By December 2026, CIO expects these spreads to rise to 260bps and 240bps, respectively. Currently, EM sovereign investment grade (IG) is trading 22bps wider than US IG, much tighter than its 10-year average of around 80bps. In spite of our forecast for modest spread widening, outright yields north of 6% on EM government and corporate debt look appealing (especially compared to 3.5% for European investment grade) and we believe a yield cushion can help insulate the asset class from renewed bouts of volatility.

How to invest?
The potential advantages of EM debt in a global portfolio include higher yields, diversification benefits, and improved fundamentals. Disadvantages include higher risk, longer duration, and greater sensitivity to geopolitical and macroeconomic shocks. EM markets are typically smaller, less transparent, and subject to evolving political and regulatory regimes—risks that must be carefully managed.

Investing in single emerging market sovereign and corporate bonds may allow the greatest flexibility to tailor portfolios to specific countries or issuers, while tuning positions to individual risk preferences and return objectives.

However, managing a portfolio of single bonds as a private investor is time-consuming. Investors must monitor interest rate risk, credit risk, and issuer risk. Liquidity can also be a concern, especially in less developed markets. And ensuring adequate diversification while meeting minimum single-bond investment sizes may require a sizeable portfolio that is out of some investors' reach.

A comparable but potentially more accessible approach is to seek building block tools that provide access to a professionally managed collection of USD-denominated government and corporate bonds from emerging markets. Active management allows for dynamic adjustment of country, interest rate, and currency exposures under strict risk control.

Pooled investment vehicles may also allow investors to access hard currency sovereign bonds from emerging markets, with some tools also diversifying further by taking opportunistic exposures to EM corporate bonds and local currency debt. And for investors keen to access EM debt but fearful of a near-term dip in bond values should the Iran war escalate, it may be possible to find structured strategies that allow one to participate in potential EM debt gains while limiting potential losses if the tool is held to maturity.

Beyond issuer risks on structured strategies, investing in EM debt involves managing exposure to liquidity, default, credit, currency, and counterparty risk.

Global asset class preferences definitions

The asset class preferences provide high-level guidance to make investment decisions. The preferences reflect the collective judgement of the members of the House View meeting, primarily based on assessments of expected total returns on liquid and commonly known indices, House View scenarios, and analyst convictions over the next 12 months. Note that the tactical asset allocation (TAA) positioning of our different investment strategies may differ from these views due to factors including portfolio construction, concentration, and borrowing constraints.

Attractive: We consider this asset class to be attractive. Consider opportunities in this asset class.

Neutral: We do not expect outsized returns or losses. Hold longer-term exposure.

Unattractive: We consider this asset class to be unattractive. Consider alternative opportunities

Note: For equities, we have a five-tier rating system with two additional preferences

Most Attractive: We consider this asset class to be among the most attractive. Investors should seek opportunities to add exposure.

Least Attractive: We consider this asset class to be among the least attractive. Seek more favorable alternatives opportunities.

When equities are included with the other asset classes in the three-tier rating system, we collapse “Most Attractive” with “Attractive” and “Least Attractive” with “Unattractive.”

Appendix

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